INTRODUCTION TO "THE CUTTING EDGE OF ANTITRUST: MARKET POWER"

LLOYD CONSTANTINE*

On October 17-18, 1991, the ABA Section of Antitrust Law devoted the third of its annual "Cutting Edge of Antitrust" programs to the topic of "Market Power." The articles published in this issue were written by some of the attorneys and economists who participated in "The Cutting Edge of Antitrust: Market Power" program. This article serves as a foreword and postscript to the articles assembled here and to the highly successful Cutting Edge program.

I. FOREWORD

The assertion that detecting actual or incipient market power1 and preventing its abuse should be the central goal of antitrust enforcement was once a viewpoint of the avant garde. It is now the dominant interpretation of the law, as market power has moved to the center stage of antitrust. A quick survey of the major provisions of the Sherman and Clayton Antitrust Acts should confirm this observation.

The touchstone of an offense under Section 2 of the Sherman Act has always been a conspiracy or attempt to monopolize or the willful acquisition or maintenance of monopoly power. The Cutting Edge program was but another forum for leading industrial organization economists to remind us that to an economist the concepts of monopoly power and market power are generally the same, notwithstanding judicial confusion to the contrary or continuing efforts to read monopoly power as a lot of market power or market power as a little bit of monopoly.

At one time the enforcement of Section 7 of the Clayton Act by federal courts and agencies included obedience to the Congressional objective of preventing high market concentration for sociopolitical, as well as broadly defined economic, reasons. Today, however, the application of

---

* Member of the New York Bar.

1 Market power can be defined as the ability of one or more firms to profitably maintain prices above a competitive level for a significant period of time. National Association of Attorneys General Horizontal Merger Guidelines § 2.11 (1987), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,405 [hereinafter NAAG Merger Guidelines].

Section 7 is almost exclusively an inquiry into whether a particular merger or acquisition is likely to produce or increase market power in an economically relevant line of commerce and section of the United States.

Litigation under Section 1 of the Sherman Act, formerly dominated by contests over whether particular conduct should be subjected to per se condemnation or analyzed under an open ended and unstructured rule of reason, increasingly involves a preliminary inquiry into market power, which will determine not only the mode of antitrust analysis, but whether a case can survive a motion for summary judgment.

For better or worse, market power analysis is now dominant and firmly entrenched in U.S. antitrust jurisprudence. Unless the Congress reorients the antitrust laws toward some other economic, political, or social values, the cutting edge issues involving market power will concern workable definitions of market power, the methods to prove and disprove its existence, and whether an assessment of market power will be required in those areas, such as price- fixing and horizontal market allocation, where it is not currently an issue. The Cutting Edge program and articles were principally addressed to these issues and to comparing the United States's singular focus on market power to the European Community's multivalued approach to defining the concept of "dominance."

II. THE MARKET POWER WEEK IN REVIEW

A number of events coincided to make the timing of the Market Power program particularly auspicious. The plan had been to provide a forum for the first public discussion of a revised set of merger guidelines to be utilized by the Antitrust Division, and perhaps the Federal Trade Commission and the State Attorneys General as well. This did not happen because the much heralded guidelines were not issued as of October 1991, nor indeed by the time this article went to press (March 1992). Therefore, a discussion of the federal government's best effort at fine-tuning the processes of market delineation and measuring and predicting the likelihood of market power had to be deferred. Also postponed was discussion of how much of the gap between the Merger Guidelines of the Department of Justice2 and the Merger Guidelines used by the National Association of Attorneys General3 had been closed in the twenty-two months since the federal-state Executive Working Group for Antitrust first convened and began the process of harmonizing these somewhat divergent merger enforcement methodologies.

---

2 U.S.Dep't of Justice Merger Guidelines (1984), reprinted in 4 Trade Reg. Rep. (CCH) ¶ 13,103.

3 NAAG Merger Guidelines, supra note 1.

Otherwise, the timing of the program was favorable. The Supreme Court had recently granted certiorari and was about to hear oral argument in *Image Technical Services v. Kodak*.[4] The record on appeal in *Image Technical* disclosed that Kodak had market shares of approximately 20 to 23 percent in the markets for copiers and micrographic machines ("copiers"). Copiers frequently require service. Until 1985, owners or lessees of Kodak copiers could service these machines with Kodak parts in three ways. They could buy parts from Kodak and service the machines themselves, they could use a Kodak technician, or they could use an independent service organization--an "ISO." The record disclosed that the ISOs provided service of equal or superior quality at as little as half the price charged by Kodak. In 1985 and 1986 Kodak stopped selling parts to the ISOs. In 1987 the ISOs sued Kodak, alleging that it was illegally tying service to the sale of parts in violation of Section 1 and monopolizing and attempting to monopolize the market for repair of Kodak machines in violation of Section 2.

After abbreviated discovery, the district court granted summary judgment for Kodak on both claims, finding that Kodak did not possess market or monopoly power in the equipment market. The court also found that Kodak parts were not a relevant product market and that Kodak's refusal to sell such parts to the ISOs could not amount to a violation of Section 2. The district

court was reversed by a divided panel of the Ninth Circuit.[5] The court of appeals found that although Kodak did not have power in the market for copiers, its power in after-markets for parts and service could be inferred from certain evidence in the record, which raised triable issues.

The appeals court also found record evidence that required trial on the issues of the existence of a market for servicing Kodak equipment, and Kodak's monopolization and/or attempt to monopolize that market.

With the Supreme Court's grant of certiorari, the legal, philosophical, and political lines were drawn for what many observers believed would be the most important antitrust decision in many years. The decision might well involve several rulings on market definition, market power treatment, and the role of those two elements in determining whether rule of reason or per se analysis is appropriate when applying summary judgment standards in an antitrust case.

The amicus curiae supporting Kodak included a host of manufacturers of complex equipment, which, similar to Kodak, desired to eliminate

---

4 Eastman Kodak Co. v. Image Technical Serv., Inc., 111 S. Ct. 2823 (1991).

5 Image Technical Serv., Inc. v. Eastman Kodak Co., 903 F.2d 612 (9th Cir. 1990).

competition from ISOs in the name of strengthening themselves in interbrand equipment markets. Supporters of Image Technical included ISOs in many other industries, and equipment buyers such as the insurance industry, which wanted to maintain competition between manufacturers and ISOs in the service markets. Despite the improved relationship between federal and state antitrust officials, the United States and a group of twenty-nine states contrasted sharply in their amicus briefs, respectively supporting Kodak and Image Technical.

Another event of the week immediately preceding the Cutting Edge program helped to frame the issues. The House of Representatives had extended debate on H.R. 1470, the so-called "Price-Fixing Prevention Act of 1991" and various proposed amendments.[6] The proposed Act would codify the rule of per se illegality for vertical price-fixing announced in the Dr. Miles[7] case. It would also partially overrule the Supreme Court's more recent decisions in Monsanto v. Spray Rite[8] and Business Electronics v. Sharp Electronics,[9] which narrowed the definition of vertical price-fixing, imposed evidentiary standards in vertical restraint cases more stringent than those in horizontal cases, and made it more difficult for public and private plaintiffs to win vertical restraint cases. Representative Thomas Campbell of California, a former Director of the Federal Trade Commission's Bureau of Competition, had offered an amendment to H.R. 1470, which at the very least, allowed a vertical price-fixer to successfully defend a suit authorized by the Act on the grounds "that the defendant was so small in the relevant market as to lack market power."[10] The debate over the so-called "Campbell Amendment," about which more will be said later, leavened the highly theoretical discussions at the Cutting Edge program with a heavy dose (or overdose) of reality.

Two other events that occurred in the week preceding the Cutting Edge program were noteworthy for their connection to the subject matter.

Judge Clarence Thomas, the author of the decision in United States v. Baker Hughes,[11] was confirmed by the Senate as an Associate Justice of the Supreme Court. In Baker Hughes, the court of appeals affirmed the district court's rejection of the government's challenge to the merger of two leading firms in the highly concentrated hardrock hydraulic under-

---

6 137 CONG. REc. H. 7,736 (Oct. 10, 1991) [hereinafter Campbell Amendment].

7 Dr. Miles Medical Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

8 Monsanto Co. v. Spray-Rite Serv. Corp., 465 U.S. 752 (1984).

9 Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717 (1988).

10 Campbell Amendment, supra note 6.

1l United States v. Baker Hughes Inc., 908 F.2d 981 (D.C. Cir. 1990).

ground drilling rig industry. BakerHughes was widely viewed as a rejection of the Justice Department's merger enforcement methodology as applied, and as an impediment to increased merger enforcement by the federal antitrust agencies. Baker Hughes was cited as one of the primary motivations for heavily revising the 1984 Merger Guidelines rather than simply fine-tuning them, as Assistant Attorney General Rill had initially characterized his plan.[12]

Judge Thomas' elevation to the seat formerly held by Justice Thurgood Marshall was viewed as another likely vote on the Court for a "Chicago School" economic interpretation of antitrust law.

Finally, as if to remind those assembled for the program of the wisdom of Professor Areeda's observation that "the best indication of market power is that it has been exercised,"[13] a major New York bank announced that it was cutting the rate of interest paid to "NOW" account holders by 50 percent, in the wake of the announced merger of Chemical Bank and Manufacturers Hanover in the same market.[14]

III. MARKET POWER: THE PROGRAM

The participants in the Cutting Edge program, some of whom have contributed articles to this issue, included three former Assistant Attorneys General in charge of the Antitrust Division, three former chief economists of the Division, three current or former FTC Commissioners, two FTC Bureau Directors, the former Chairman and a current representative of the Antitrust Task Force of NAAG, an antitrust official from the European Commission, and the economist Alfred Kahn. Former AAG William Baxter, the architect of the Reagan Administration's antitrust program, and I presented introductory and closing remarks and served as commentators throughout the program.

As I noted in my introductory comments, although the detection and avoidance of market power is an important concern of antitrust, it is not and should not be the only or even primary focus of the law. An antitrust law focused solely on market power would trivialize the longer list of economic, social, and political values the laws were enacted to foster. Among these values are technological diversity and innovation. Innovation is more important that allocative efficiency in lowering the price and improving the quality of goods and services.

12 Remarks of James F. Rill, Assistant Attorney General, Antitrust Div'n, U.S. Dep't of Justice, at the 23d Annual New England Antitrust Conf., Cambridge, Mass. (Nov. 3, 1989).

13 Areeda, Market Definition and Horizontal Restraints, ANTITRUST LJ. 553, 554 (1983).

14 Citibank to Cut Its NOW Rates, N.Y. Times, Oct. 14, 1991, DS, col. 4.

In those areas of antitrust law where markets must be defined and actual or potential power assessed, the picture other practitioners and I observe is not a pretty one. Frederick Rowe has written of the "market as mirage."[15] He has termed "quixotic" the long quest for properly delineated markets begun with Learned Hand's decision in Alcoa.[16] For Rowe, the market has become the "joker,... bloody mess [and] intellectual blackhole" of antitrust law.[17] George Stigler echoes this statement, writing that, "The typical antitrust case is an almost impudent exercise in economic gerrymandering .... [T]he determination of markets has re mained an undeveloped area of economic research at either the theoretical or empirical level.'[18] Yet the courts and government agencies are confidently making decisions on the basis of these gerrymandered market definitions. But as Stigler has implied, neither economics nor this area of economic research has approached the level of precision (nor may it ever) necessary to dominate antitrust, a body of law involving a national policy of the first magnitude.

Allowing market power or any other single and malleable economic construct to be dispositive of antitrust disputes invites gamesmanship and intellectual dishonesty in an area too important for games. David Scheftman's excellent paper and oral presentation[19] "demonstrated how statistical measures of market power can be manipulated to vary the angle of a demand curve to demonstrate either the absence or presence of market power."[20] Such gamesmanship is not limited to the courtroom, but takes place on the floor of the House of Representatives as well. When Representative Campbell introduced the amendment that would impose a market power screen in vertical price-fixing cases, he was met with the objection of House colleagues that this might immunize large retailers and most of the Fortune 500 from application of the law. To allay such fears, Campbell told the House that under the DOJ Merger Guidelines one could find that firms with 14 percent market share possessed market power.[21] He also cited Brown Shoe[22] and Von's Grocery;[23] as

15 Rowe, Market as Mirage, 75 CALIV. L. REv. 991 (1987).

16 United States v. Aluminum Co. of America, 148 F.2d 416 (2d Cir. 1945).

17 Rowe, supra note 15, at 995.

18 Stigler, The Economists and the Problem of Monopoly, in THE ECONOMIST AS PREACHER 51 (1985).

19 Scheftman, Statistical Measures of Market Power, infra this issue, 60 ANTITRUST LJ. 901 (1992).

20 ABA Probes Emerging Issues in Analysis of Market Power, Antitrust & Trade Reg. Rep. (BNA) No. 1538 at 495, 499 (Oct. 24, 1991).

21 Campbell Amendment, supra note 6.

22 Brown Shoe Co. v. United States, 370 U.S. 294 (1962).

23 United States v. Von's Grocery Co., 384 U.S. 270 (1966).

cases in which the courts had found that firms with 3 percent to 5 percent market share possessed market power.[24]

Those who approve per se treatment for vertical price- fixing may view Campbell's creative advocacy as necessary to kill or render innocuous a bad bill. But this first legislative attempt to codify a market power screen presents a powerful lesson in why the antitrust laws should not be reduced to a single economic inquiry so susceptible to manipulation.

The Cutting Edge program, true to its billing, provided a forum for airing state of the art thinking about the utility of market power analysis and the advisability of extending the analysis into areas of antitrust law such as horizontal price-fixing, market allocation, and the Robinson-Patman Act. New approaches to measuring market power were also discussed. Although nothing approaching a consensus was reached on any of these issues, George Hay offered one proposal which apparently had wide support.[25] Hay noted that under the economist's definition of market power, i.e., profitably pricing above marginal cost, nearly all firms in the United States possessed some degree of market power. Therefore, Hay proposed that a definition of market power that would be more useful in antitrust would include a substantiality test. He would require a finding of a defined degree of power for a defined period of time.

Not represented in the articles but discussed at length during the program was the European Commission's interpretations of dominance and "abuse of a dominant position" under Article 86 of the Treaty of Rome, the rough analogue to Sherman Act Section 2. As explained by BerendJ. Drijber of the Commission's legal department, the Commission has interpreted dominant position in a much more expansive manner than the U.S. concept of market power. This interpretation includes the U.S. market power concept, but also incorporates sociopolitical values such as "fairness" and "market unification."

Professor Baxter criticized the European approach to interpreting "dominance" because it was an attempt to study "biology without a microscope." Then and now I was permitted the last word, and rejected the assertion that economic science had or would approach the level of precision found in biology or physics. Europe had the U.S. antitrust record spread before it when it began to wrestle with its own regime of competition law. It has chosen to adopt a multivalued approach that incorporates economic, political, and social values. Similarly, our Congress should reinvest the antitrust law with values beyond neo-classical

---

24 Campbell Amendment, supra note 6, at 7,752.

25 Hay, Market Power in Antitrust, infra this issue, 60 ANTITRUST LJ. 807 (1992).

welfare economics and provide specific rules by way of codification. The outcome of the Image Technical case, the legislative response to that decision, and the ultimate formulation of the "Price Fixing Prevention Act" will provide important tests of whether Congress will reassert its influence in this area. If not, Congress will leave the field in the state discussed and dissected by the Market Power authors and program participants.